

STATE OF MICHIGAN
IN THE SUPREME COURT

TOMRA OF NORTH AMERICA,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,

Defendant-Appellant.

Supreme Court No. 158333

Court of Appeals No. 336871

Court of Claims No. 16-000118-MT

REPLY BRIEF OF APPELLANT DEPARTMENT OF TREASURY

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ARGUMENT

I. Tomra's defense of the Court of Appeals' decision demonstrates that the outcome below violated well established rules of statutory construction.

The plain language of the industrial processing exemption statute confirms that property must be used during an industrial process to qualify for the exemption. MCL 205.54t(7)(a) (defining "industrial processing" as a process beginning when tangible personal property moves from raw material storage and ending when finished goods arrive in finished goods inventory); MCL 205.94o(7)(a) (same); see also MCL 205.54t(2) (limiting the scope of the exemption to property "used for the exempt purpose stated in this section"); MCL 205.94o(2) (same). As applied to this case, it means that bottle return machines do not qualify for the exemption because they perform an activity before an industrial process begins.

Tomra and the Court of Appeals do not take on this statutory language directly; instead, both posit that reading subsection (7)(a)'s second sentence as limiting the exemption renders another subsection of the exemption statute nugatory, specifically subsection (3). (Tomra Br in Opp'n, pp 13–14.) Treasury disagrees.

Subsection (7)(a)'s temporal requirement does not render the industrial processing activities listed by the Legislature in subsection (3) nugatory. Those activities are still considered exempt activities so long as they are performed within the temporal guidelines set forth by the statute. That interpretation reads the subsection (3) activities in context and in harmony with subsection (7)(a)'s entire definition.

Tomra does not reconcile subsection (7)(a)'s temporal language with subsection (3) activities. Tomra instead puts forth interpretations that runs afoul of bedrock principles of statutory construction applicable to all statutes, and do not comport with the rules applicable specifically to tax exemption statutes.

According to Tomra, equipment that performs "subsection (3) activities are exempt *without regard to subsection (7)(a).*" (Tomra Br in Opp'n, p 13 (emphasis added).) In other words, Tomra is indicating that the language of (7)(a) is surplusage that should be ignored. This is directly contrary to the fundamental principle of statutory construction applicable to all statutes that requires every word to be given meaning and effect. *Township of Casco v Sec of State*, 472 Mich 566, 591 (2005).

Tomra's interpretation also results in an improper expansion of an exemption by implication. Specifically, Tomra takes the position that subsection (3) can have meaning only if the activities identified in that subsection are "excluded from *any limitation.*" (Tomra Br in Opp'n, p 14 (emphasis added).) Thus, in Tomra's view, whenever a taxpayer engages in an action or performs a function that could fall within the activities listed in subsection (3), that taxpayer is engaged in exempt activity—regardless of when that activity takes place, or for what purpose that activity was performed. Under Tomra's proposed reading of the statute, any individual that participates in an activity that could be characterized as part of the "stream" of recycling, is engaged in exempt activity. For example, an individual that decides not to collect the 10 cent deposit available for his soda cans, and

instead crushes them himself and delivers them to a scrapper that pays him based on the total weight of the returned cans would be engaged in exempt activity simply because the act of crushing the can changed its form and the can at some point *may* be used in the creation of another item that is ultimately sold at retailer. This result would not conform to the well settled principle that tax exemption statutes cannot be expanded. *Evanston YMCA Camp v State Tax Comm'n*, 369 Mich 1, 8 (1962).

Moreover, Tomra's claim that no limitations can be imposed is without merit because it is not necessary to ignore the temporal requirement in subsection (7) in order to give meaning to subsection (3). Even if those activities can be characterized as an enlargement of the definition of industrial processing set forth in subsection (7), they should be viewed only as an enlargement of the first sentence, not as eliminating the temporal requirement set forth in the second sentence of subsection (7). Stated differently, the Legislature identified activities in subsection (3) that do not themselves change the form, composition, quality, combination or character of property to be sold at retail, but may still qualify as an industrial processing activity, so long as they are performed within the temporal guidelines set forth by the statute.

Tomra's interpretation of the statute should also fail because it requires that an ambiguity in an exemption statute be resolved in favor of the taxpayer, instead of in favor of Treasury. As noted above, Tomra insists that subsection (3) can be given meaning only if the temporal requirement set forth in subsection (7) is

ignored. But if one provision of a statute is meaningless unless another section of the same statute is ignored, one must conclude that the statute is ambiguous. An ambiguity exists when a provision “irreconcilably conflicts with another provision or when it is equally susceptible to more than a single meaning.” *Mayor of City of Lansing v Michigan Public Service Comm*, 470 Mich 154, 166 (2004). Ambiguities in an exemption statute must be resolved in favor of Treasury. *Evanston*, 369 Mich at 7. Even Tomra recognizes that this is the correct rule. (Tomra Br in Opp’n, p 10.)

Yet the Court of Appeals did not follow this principle. Specifically, the opinion below stated: “[w]e also note that, although tax exemptions are construed strictly against the taxpayer, any ambiguity found in a tax statute is construed in favor of the taxpayer.” *Tomra of North America v Dep’t of Treasury*, ___ Mich App ___ (2012) (Docket No. 336871), Slip op, 6 (citations omitted). This statement is directly contrary to this Court’s holding in *Evanston* and by itself serves as an adequate basis for this Court to grant review. Moreover, the case cited in support of the statement that ambiguities must always be resolved in favor of the taxpayer, *Signature Villas LLC v Ann Arbor*, 269 Mich App 694 (2006), analyzed a tax imposition statute, not a tax exemption statute.

The Court of Appeals’ failure to recognize and apply a bedrock principle of law applicable to tax exemption statutes likely led to the erroneous determination in this case. Had the Court properly construed the statute in Treasury’s favor, it would have upheld the trial court’s decision below.

II. The industrial processing exemption's history demonstrates why Tomra's position in this matter is without merit and why this application should be granted.

Tomra asserts that the activities listed in subsection (3) were added as part of an expansion of the industrial processing exemption enacted by the Legislature by way of 1999 PA 117. (Tomra Br in Opp'n, p 8.) Treasury disagrees with this characterization.

While the amendments to the industrial processing statute admittedly extended the availability of the exemption to taxpayers other than those that would themselves qualify as industrial processors, the Legislature also added language limiting the exemption, including the temporal language that is central to this dispute.

Prior to the amendments made by 1999 PA 117, Treasury had adopted an administrative rule that provided guidance for the industrial processing exemption and included an illustrative list of activities that could, but would not necessarily, constitute industrial processing activities. Mich Admin Code, R 205.90(5)(a–g). The list of activities set forth in subsection (3) largely mirrors that list. Yet the Legislature did not merely codify the list; it also adopted the limitation set forth in subsection (2) that property “is exempt only to the extent that the property is used for the exempt purpose stated in this section.” MCL 205.94o(2); MCL 205.54t(2). The Legislature also included language that did not appear in the administrative rule: the temporal requirement set forth in the second sentence of subsection (7). These changes, when viewed together, indicate that the purpose of the amendment was not simply to enlarge the availability of the exemption. Should this Court

grant Treasury's application for leave to appeal, the regulatory history and its relationship to the administrative rules that preceded the amendments can be explored in more detail in a merits brief.

III. Tomra's argument that the Court of Appeals reached the correct result is based on a misreading of *Detroit Edison*.

Tomra asserts that this Court held in *Detroit Edison Co v Department of Treasury*, 498 Mich 28 (2015), that "neither raw material storage nor finished good storage is required for exempt industrial processing to occur." (Tomra Br in Opp'n, p 19.) Treasury disagrees with this characterization of the *Detroit Edison* holding.

Tomra relies heavily of a single footnote in *Detroit Edison* to support its view that the Court of Appeals' interpretation of the exemption statute was correct. This footnote is not a basis to uphold the Court of Appeals' holding, and in fact—when properly read in context—demonstrates why Tomra's position in this matter is without merit and why this application should be granted.

The footnote Tomra relies on indicates that the general definition of "industrial processing" is set forth in subsection (7), but that "the statute also provides that certain specific activities that do not satisfy the general [subsection (7)] definition nonetheless constitute 'industrial processing' activity for purposes of the statute." *Detroit Edison*, 498 Mich at 49 n 13. Tomra argues that this language indicates that this Court agrees that the temporal requirement set forth in the second sentence of subsection (7) does not apply to the activities listed in subsection (3). Treasury disagrees.

The language of footnote 13, when read in context with the discussion in that part of the *Detroit Edison* decision, should not be viewed as allowing the entire second sentence of the industrial processing definition to be disregarded. Instead, it should be viewed as clarifying that the types of activity identified in subsection (3), that do not on their face appear to be consistent with the description of industrial processing in the first sentence of subsection (7), could still qualify for the exemption. Otherwise, the only possible construction is that the second sentence of subsection (7) has no meaning—a result that runs contrary to one of the bedrock principles of statutory construction as explained above. In addition, the last sentence of the footnote states: “[s]till, only property used for a single activity is exempt from the use tax: property used for industrial processing.” *Id.* This statement makes clear that the inquiry whether a taxpayer can benefit from the industrial processing exemption is not complete just because a taxpayer shows that it engages in conduct that can be described as “quality control” or any other activity described in subsection (3). Instead, the taxpayer must show that the action is undertaken as part of an industrial processing activity—an inquiry that is informed by the temporal requirement set forth in subsection (7).

IV. Tomra’s attempt to downplay the significance of the Court of Appeals’ decision and its possible future impact lacks merit.

Tomra argues that this Court should not review this case because the decision has minimal impact. (Tomra Br in Opp’n, pp 23–24.) Treasury disagrees.

In support of its claim that the holding below lacks the necessary significance to warrant review from this Court, Tomra asserts that it impacts a small industry.

(Tomra Br in Opp’n, p 3.) But even if there are only be a few bottle return machine sellers that operate in Michigan, the Court of Appeals did not limit its holding to only bottle return machines.

Tomra also inaccurately claims that no taxpayers have had their exemption limited based upon the absence of raw material storage or finished good storage in the last two decades. Recently, there have been multiple cases that involved issues related to the availability of the industrial processing exemption based on whether industrial processing had begun in accordance with the temporal requirement set forth in subsection (7). See *Kappan Tree Service, LLC v Dep’t of Treasury*, unpublished opinion per curiam of the Court of Appeals, issued April 26, 2016 (Docket No. 325984) (Ex 1); *Great Lakes Hydrodemolition Services, Inc v Dep’t of Treasury*, unpublished Michigan Tax Tribunal decision, issued January 13, 2015 (Docket No. 461232) (Ex 2). While these cases do not constitute binding authority, they do demonstrate that this is an issue of continuing importance.

In addition, Tomra attempts to downplay the significance of the potential financial impact of the decision by emphasizing that the amount at stake in this case (Docket No. 158333) “is hardly millions [of dollars],” yet it ignores that when the amount at issue in the companion case (Docket No. 158335) is added to the tally, nearly three million dollars is at stake for a dispute involving a period of only a few tax years and a single taxpayer. The fact that a single taxpayer making this type of claim for one type of property for a limited tax period involves such a large figure demonstrates the potential impact the holding below could have.

V. Tomra's opposition brief misconstrues the opinion below and Treasury's position in this case.

Tomra's brief misinterprets the holding below. Specifically, Tomra states that the court below "held that the [bottle return machines] qualify for industrial processing exemption because they convert and condition tangible personal property—used beverage containers—by changing the form, composition, quality, combination, or character of the property for ultimate sale at retail and perform inspection, quality control, testing, remanufacturing, production material handling, recycling activities and storage of in-process materials that the Legislature specifically included in the definition of qualified 'industrial processing.'" (Tomra Br in Opp'n, p 1 (citations omitted).) In fact, the Court of Appeals did not make any findings related to the nature of the activity performed by the bottle return machines. Instead, the Court of Appeals considered only whether the Court of Claims had improperly analyzed the applicability of the second sentence of subsection (7) to the types of activities listed in subsection (3) and ultimately held that the timing of the activities listed in subsection (3) is immaterial when determining whether the industrial processing exemption applies.

The fact that the Court of Appeals remanded the matter for "further proceedings not inconsistent with this opinion" demonstrates that the Court was aware that its holding did not automatically entitle Tomra to judgment in its favor, only that Treasury wasn't entitled to summary disposition for the reason that had previously been articulated by the trial court.

Tomra also mistakenly claims that Treasury “no longer challenges the determination that the Container Recycling Machines conduct activities (inspection, testing, quality control, sorting, crushing, shredding and recycling) that are identified as industrial processing activities under subsection (3).” (Tomra Br in Opp’n, p 12.) That statement is not true. Again, the Court of Appeals did not determine that the bottle return machines perform those activities, and Treasury never agreed that the bottle return machines performed those activities. In fact, Treasury asserted in the trial court and in the Court of Appeals that there were several reasons that Tomra was not entitled to the industrial processing exemption, including Tomra’s inability to prove that the alleged exempt equipment performs the specific activities that are considered industrial processing activities. Treasury has not abandoned or conceded those arguments nor any of its alternative claims.

CONCLUSION AND RELIEF REQUESTED

The Court of Appeals ignored the plain language of the industrial processing exemption and this Court’s precedent by rendering nugatory an entire sentence from a statutorily defined term. These circumstances will cause confusion amongst taxpayers, impact the public coffers, and disrupt the well-established principles of statutory construction. These consequences should be prevented by this Court. The proper application of the industrial processing exemption is an important question, affecting both the State and Michigan’s citizens. Accordingly, Treasury respectfully requests that this Court grant its application for leave to appeal.

Respectfully submitted,

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